No. 92-851

In the Supreme Court of the United States

OCTOBER TERM, 1992

CENTRAL BANK OF DENVER, N.A., PETITIONER

v.

FIRST INTERSTATE BANK OF DENVER, N.A., AND JACK K. NABER

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

WILLIAM C. BRYSON
Acting Solicitor General

MAUREEN E. MAHONEY
Deputy Solicitor General

THOMAS G. HUNGAR
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

BRIAN D. BELLARDO
Assistant General Counsel

MICHAEL G. LENETT
Special Counsel

SUSAN B. MANN
Senior Counsel
Securities and Exchange Commission
Washington, D.C. 20549

QUESTIONS PRESENTED

1. Whether an indenture trustee for a municipal bond offering may be held liable for recklessly aiding and abetting violations of antifraud provisions of the Securities Exchange Act of 1934 in connection with the offering even though the trustee had no duty of disclosure under the trust indenture.

2. Whether recklessness, in contrast to actual knowledge, is sufficient to satisfy the scienter element of aiding-and-abetting liability under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), where the defendant's substantial assistance of the primary wrongdoing consisted of affirmative action rather than pure inaction or silence.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases—Continued: Page

Cases—Continued: Page

Statutes and regulation:

In the Supreme Court of the United States

OCTOBER TERM, 1992

No. 92-854

CENTRAL BANK OF DENVER, N.A., PETITIONER

v.

FIRST INTERSTATE BANK OF DENVER, N.A., AND JACK K. NABER

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is filed in response to the Court's invitation to the Solicitor General to express the views of the United States.

STATEMENT

1. In two separate offerings in 1986 and 1988, the Colorado Springs-Stetson Hills Public Building Authority (the Authority) sold bonds to finance public improvements built by the developer of a planned community in Colorado Springs, Colorado. The bonds were secured by land that was required to have an appraised value of at least 160% of the outstanding principal and interest (the 160% test). Petitioner served as the indenture trustee for both offerings.[1] Pet. App. A4-A5.

[1] Petitioner's role and duties as trustee for the bonds are set forth in the trust indentures for the 1986 and 1988 bonds. See Pet. App. A41-A50 (excerpts of 1988 indenture).

In early 1988, before the 1988 bond offering had commenced, petitioner received an appraisal from the same appraiser who had appraised the property securing the 1986 bonds. The 1988 appraisal updated the original 1986 appraisal of the land securing the 1986 bonds and, in addition, valued the separate parcels that were to secure the 1988 bonds. The 1988 appraisal showed land values essentially unchanged from the earlier 1986 appraisal. Pet. App. A5-A6. Petitioner knew that real estate values had declined in the Colorado Springs area in that two-year period. *Id.* at A7 n.6.

Thereafter, petitioner received two letters from the underwriter for the 1986 offering. Those letters stated that the 160% test for the 1986 offering was not being met and expressed concern that the original appraisal for the 1986 bonds was outdated, that the 1988 appraisal was using inflated real estate values, and that the Authority may have given "false and misleading certifications" of compliance with the 1986 bond covenants. Pet. App. A6. Petitioner's investigation of the 1988 appraisal raised similar questions concerning the accuracy of the appraisal and the sufficiency of the collateral. Accordingly, as trustee for the 1986 bonds, petitioner directed "that an independent review of the appraisal be conducted by a different appraiser." *Id.* at A7.

Petitioner then held a series of meetings concerning the appraisal with representatives of the Authority, the developer, and others. As a result of those meetings, petitioner dropped its demand for an immediate review of the appraisal. Instead, petitioner agreed to defer the review until December 1, 1988—six months after the 1988 bonds were to be sold—in exchange for the developer's agreement to pledge an additional $2 million in property as security for the 1986 bonds. Pet. App. A8 & n.7. No additional property was pledged as security for the 1988 bonds. *Id.* at A27.

The 1988 bonds were sold in June 1988. Pet. App. A4. In December 1988, the independent appraisal of the

collateral was begun, but the Authority refused to complete that appraisal. Instead, the Authority defaulted on its payment obligations for the 1988 bonds. *Id.* at A9.

2. Respondents, purchasers of some of the 1988 bonds, brought this action in the United States District Court for the District of Colorado against petitioner and others connected with the offering, alleging that the 1988 bonds were sold as part of a fraudulent scheme in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5. Respondents alleged that the bonds were marketed through a fraudulently false and misleading disclosure document that represented the 1988 appraisal as being correct but that failed to disclose the doubts raised about the accuracy of that appraisal and the sufficiency of the collateral. Respondents further alleged that petitioner, with actual knowledge or recklessness, aided and abetted the fraudulent scheme by withdrawing its demand for an immediate independent review of the appraisal and by agreeing to delay the review until after the 1988 bonds had been sold. Pet. App. A4, A9, A20, A27 & n.19.

The district court granted summary judgment for petitioner. Pet. App. A29-A36. The court held that the scienter requirement for aiding-and-abetting liability "may not be satisfied by showing recklessness absent an additional duty to disclose." *Id.* at A33. Since respondents had failed to raise a genuine issue of material fact as to petitioner's actual knowledge or the existence of a duty to disclose, the court rejected respondents' aiding-and-abetting claim.

3. The court of appeals reversed and remanded. Pet. App. A3-A28. The court began its analysis by agreeing with the district court that petitioner owed respondents no duty to disclose. The court explained that, under the Trust Indenture Act of 1939, 15 U.S.C. 77aaa *et seq.*, petitioner's duties as bond indenture trustee were "strictly defined and limited to the terms of the indenture." Pet.

App. A20 (citing *Elliott Assocs.* v. *J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66, 71 (2d Cir. 1988); 15 U.S.C. 77*ooo*(a)(1)). The court held, however, that "the lack of a duty to disclose is not dispositive in this case," because the Trust Indenture Act leaves undisturbed whatever "rights, obligations, duties [, or] liabilities" are imposed by the federal securities laws. Pet. App. A20 (citing 15 U.S.C. 77zzz). Accordingly, the court concluded that petitioner could be liable for aiding and abetting notwithstanding the absence of any duty to disclose. Pet. App. A20-A21.

Turning to the question of petitioner's liability as an aider and abettor, the court observed that "[s]everal courts expressly have held that recklessness satisfies the scienter requirement for aiding-and-abetting liability" (Pet. App. A21), while other courts "have indicated that recklessness is not sufficient scienter for aiding-and-abetting liability unless the defendant had a fiduciary duty." *Id.* at A22. Adopting the former view, the court of appeals held that, where a defendant affirmatively takes action to assist a primary violation of the securities laws, an allegation of recklessness is sufficient to satisfy the scienter requirement for aiding-and-abetting liability even absent a duty to disclose. *Id.* at A23-A25 (citing *Levine* v. *Diamanthuset, Inc.*, 950 F.2d 1478, 1484-1485 & nn. 4-5 (9th Cir. 1991); and *FDIC* v. *First Interstate Bank*, 885 F.2d 423, 432-433 (8th Cir. 1989)).

The court of appeals also concluded that this case involves allegations of affirmative action, not mere silence or inaction, because petitioner "affirmatively agree[d] to delay the independent review of the [1988] appraisal." Pet. App. A23. Accordingly, the court held that recklessness was the appropriate standard of scienter in the circumstances of this case, and turned to an examination of the record to determine whether the trier of fact could reasonably conclude that petitioner's conduct was reckless. *Id.* at A25-A26.

Considering the evidence in the light most favorable to plaintiffs, the court found that petitioner's decision to delay the independent review of the 1988 appraisal was highly unusual, and that "this was not an ordinary transaction." Pet. App. A26. Moreover, petitioner had agreed to delay the independent review despite its concerns about the accuracy of the appraisal and its knowledge of the upcoming sale of the 1988 bonds. Under those circumstances, the court concluded that the record would support a finding of recklessness. *Id.* at A27.[2]

DISCUSSION

The court of appeals held that an indenture trustee can be subjected to liability for aiding and abetting a violation of the securities laws in the absence of a breach of the trustee's duties as set forth in the trust indenture. Petitioner's challenge to that ruling does not present a significant legal issue warranting this Court's review.

The court of appeals also held that recklessness satisfies the scienter requirement for aiding-and-abetting liability under Section 10(b) and Rule 10b-5 in cases in which the defendant's affirmative action substantially assists the primary violation, even if the defendant does not owe a duty of disclosure to the plaintiff.[3] Although we believe that the court's decision was correct, we agree with petitioner that this issue warrants review. In our view, the courts of appeals have adopted materially different tests for determining when recklessness satisfies the scienter element of aiding-and-abetting liability. Because the passage of time does not appear to be lessening the

[2] The court of appeals also concluded that the evidence would support a finding that, by agreeing to delay the independent review of the 1988 appraisal, petitioner provided "substantial assistance" to the fraudulent scheme. Pet. App. A28.

[3] As noted above, the court of appeals held that petitioner owed no duty of disclosure to respondents. Pet. App. A20. Respondents do not appear to dispute that holding.

disagreement among the circuits in this regard, review by this Court is necessary to resolve the conflict.

1. Petitioner contends (Pet. 5-10; Pet. Reply Br. 2-4) that, as a matter of law, a bond indenture trustee cannot be deemed to have acted recklessly so long as it has satisfied its obligations under the trust indenture. According to petitioner (Pet. 4, 7), the court of appeals' decision to the contrary "eviscerates the protections for indenture trustees" under, and "directly conflicts" with, the Trust Indenture Act of 1939 (TIA), 15 U.S.C. 77aaa *et seq.*

The question framed by petitioner does not arise on the facts of this case. Petitioner states (Pet. 2) that the bonds involved in this case are municipal bonds. As a result, the TIA appears to have no applicability here. Pursuant to Section 304(a)(4)(B) of the TIA, "[t]he provisions of [the TIA] shall not apply to * * * any security exempted from the provisions of the Securities Act of 1933 * * * by paragraph (2) of subsection 3(a) thereof." 15 U.S.C. 77ddd(a)(4)(B).[4] Section 3(a)(2) of the Securities Act of 1933, in turn, exempts all securities (such as municipal bonds) issued by the States and their political subdivisions or instrumentalities. 15 U.S.C. 77c(a)(2).[5]

---

[4] As the statutory language expressly provides, the exemption provided by Section 304(a) of the TIA is an exemption from the TIA as a whole, not merely an exemption from any one provision of the Act. See *Friedman* v. *Chesapeake & O. Ry.*, 261 F. Supp. 728, 731 (S.D.N.Y. 1966) (exempt from "the provisions of the [TIA]"), aff'd, 395 F.2d 663 (2d Cir. 1968) (per curiam), cert. denied, 393 U.S. 1016 (1969); *Dau* v. *Storm Lake Production Credit Ass'n*, 626 F. Supp. 862, 864 (N.D. Iowa 1985); *Dau* v. *Federal Land Bank*, 627 F. Supp. 346, 348-349 (N.D. Iowa 1985); 4 L. Loss & J. Seligman, *Securities Regulation* 1641 (3d ed. 1990).

[5] The Authority represented in the Official Statement for the 1988 bonds (second unnumbered page) that the bonds were not registered under the Securities Act of 1933, presumably because it concluded that the bonds were exempt from such registration as municipal bonds issued by a political subdivision of the State. See also Official Statement, first unnumbered page (referring to "the Authority or any *other* political subdivision") (emphasis added).

In any event, even if the 1988 bonds were subject to the TIA, that Act would not immunize petitioner from liability in this case. Petitioner relies on Section 315(a)(1) of the TIA, which permits trust indentures to provide that "the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in [the] indenture." 15 U.S.C. 77*ooo*(a)(1).[6] Section 326 of the TIA states, however, that "[e]xcept as otherwise expressly provided, nothing in [the TIA] shall affect * * * the rights, obligations, duties, or liabilities of any person under" other federal securities laws, including the Securities Exchange Act of 1934. 15 U.S.C. 77zzz.[7] Petitioner appears to concede (Pet. Reply Br. 2) that the TIA does not establish immunity from claims of securities fraud violations, which form the basis of this suit.

---

[6] After the events at issue in this case, Section 315(a) was amended to state that this provision would automatically be deemed included in every trust indenture absent an express statement to the contrary. See Trust Indenture Reform Act of 1990, Pub. L. No. 101-550, Tit. IV, § 414, 104 Stat. 2730.

[7] The "[e]xcept as otherwise expressly provided" clause of Section 326 is not a reference to Section 315. That clause refers instead to provisions like Section 310(c) of the TIA, 15 U.S.C. 77jjj(c), which expressly exempts indenture trustees from any inconsistent requirements that might be imposed by another securities law in certain circumstances. See also TIA § 305(d), 15 U.S.C. 77eee(d) (expressly exempting certain conduct from specified provisions of the Securities Act of 1933). Section 315 contains no such language; indeed, it does not even refer to the provisions of any other securities laws, and thus cannot be deemed to "expressly provide[]" for an exemption from those laws within the meaning of Section 326.

Petitioner asserts (Pet. 6; Pet. Reply Br. 2, 4) that it is a "logical impossibility" for it to have acted recklessly when it "did not breach any of its indenture duties" and therefore was "complying with all terms of the Indenture." [8] What petitioner ignores, however, is that under the Securities Exchange Act it is unlawful for any person to knowingly or recklessly aid and abet a violation of Section 10(b). Thus, wholly independent of petitioner's duties under the trust indenture, and regardless of whether petitioner satisfied those duties, petitioner's conduct is actionable under Section 10(b) to the same extent it would have been in the absence of the trust indenture. See Pet. App. A20-A21, A28.

Petitioner cites no court of appeals decision to the contrary. Petitioner places principal reliance on *Elliott Assocs.* v. *J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66 (2d Cir. 1988), but that case is wholly inapposite. In *Elliott Assocs.*, the plaintiffs asserted only that the indenture trustee had breached its duties "under the indenture, the [Trust Indenture] Act[,] and state law." 838 F.2d at 67. No claim was asserted under the Securities Exhange Act, and thus the court had no occasion to consider the effect of Section 326 of the TIA, 15 U.S.C. 77zzz, which makes clear that the TIA does not

[8] It is far from clear that petitioner is correct in asserting that it complied with all of its obligations under the trust indenture and the TIA. Section 315(d)(2) of the TIA provides that an indenture trustee is not protected from liability for "any error of judgment made in good faith * * * [where] it shall be proved that such trustee was negligent in ascertaining the pertinent facts." 15 U.S.C. 77*ooo*(d)(2). Similarly, while the indenture gave petitioner the discretionary right to require an independent appraisal of the collateral, it required petitioner to exercise that discretion in a non-negligent manner. Pet. App. A44, A45 (Indenture of Trust, Section 9.01(g) and (k)). Thus, the TIA and the trust indenture do not immunize petitioner from liability even for negligence; *a fortiori*, they provide no protection against respondents' allegations of reckless misconduct.

override the obligations and duties imposed by the Securities Exchange Act.[9]

Similarly, petitioner's reliance (Pet. Reply Br. 3 n.2) on *Ross* v. *Bank South, N.A.*, 837 F.2d 980, 1003, vacated, 848 F.2d 1132 (1988), on reh'g, 885 F.2d 723 (11th Cir. 1989) (en banc), cert. denied, 495 U.S. 905 (1990), is misplaced. That opinion was vacated by the full Eleventh Circuit, and it therefore has no precedential effect. See *County of Los Angeles* v. *Davis*, 440 U.S. 625, 634 n.6 (1979). Moreover, the vacated panel opinion in *Bank South* did not suggest that an indenture trustee may recklessly aid and abet securities fraud with impunity so long as it complies with its obligations under the trust indenture; rather, the *Bank South* panel pointed to the trustee's compliance with its duties as merely one factor tending to support the conclusion that the trustee had not aided and abetted the fraud. 837 F.2d at 1003. Accordingly, there is no conflict on this question, and the court of appeals' correct ruling would not warrant further review even if the TIA were applicable in this case.

2. a. Petitioner contends (Pet. 10-15) that the court of appeals erred in holding that proof of recklessness is sufficient to satisfy the scienter requirement for aiding-and-abetting liability in cases in which the defendant's affirmative acts assisted a primary violation of the securities laws. In our view, the court of appeals was correct in adopting a recklessness standard in the circumstances of this case.

The precise formulation of the test for aiding-and-abetting liability under Section 10(b) and Rule 10b-5 varies from circuit to circuit.[10] In general, however, a

[9] The district court in *Lorenz* v. *CSX Corp.*, 736 F. Supp. 650, 658 (W.D. Pa. 1990), also did not discuss or even refer to Section 326, and thus its analysis of the liability of indenture trustees under the securities laws is necessarily flawed.

[10] This Court has left open the question whether a cause of action for aiding-and-abetting liability exists under Section 10(b)

plaintiff must prove three elements in order to impose aiding-and-abetting liability on a defendant: (1) the existence of a primary Section 10(b) violation by another; (2) scienter on the part of the alleged aider and abettor; and (3) substantial assistance by the alleged aider and abettor in achieving the primary violation.[11] This case

---

and Rule 10b-5. See *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 379 n.5 (1983); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 192 n.7 (1976). Every court of appeals to address the question (with the arguable exception of the Seventh Circuit) has held that aiding-and-abetting liability is available under Section 10(b) and Rule 10b-5. See note 11, *infra*. Petitioner does not dispute that proposition, which we believe has been correctly settled by the courts of appeals.

[11] See, *e.g.*, *Cleary* v. *Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *IIT, An International Investment Trust* v. *Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980); *Monsen* v. *Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir.), cert. denied, 439 U.S. 930 (1978); *Schatz* v. *Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991), cert. denied, 112 S. Ct. 1475 (1992); *Abell* v. *Potomac Ins. Co.*, 858 F.2d 1104, 1126 (5th Cir. 1988), vacated in part on other grounds, 492 U.S. 914 (1989), and cert. denied, 492 U.S. 918 (1989); *Herm* v. *Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *K & S Partnership* v. *Continental Bank, N.A.*, 952 F.2d 971, 977 (8th Cir. 1991), cert. denied, 112 S. Ct. 2993 (1992); *Jett* v. *Sunderman*, 840 F.2d 1487, 1495 (9th Cir. 1988); *Farlow* v. *Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 986 (10th Cir. 1992); *Woods* v. *Barnett Bank*, 765 F.2d 1004, 1009 (11th Cir. 1985).

The Seventh Circuit has adopted a different test for aiding-and-abetting liability. In order for a defendant to be liable for aiding and abetting under that test, he must "(1) commit one of the 'manipulative or deceptive' acts prohibited under section 10(b) and rule 10b-5 (2) with the same degree of scienter that primary liability requires." *Robin* v. *Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990), cert. denied, 111 S. Ct. 1317 (1991); see *LHLC Corp.* v. *Cluett, Peabody & Co.*, 842 F.2d 928, 932 (7th Cir.), cert. denied, 488 U.S. 926 (1988); *Barker* v. *Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986). One commentator has argued that the Seventh Circuit's test "would eliminate aiding and abetting liability because the defendant who met the requirements would be liable as a primary violator." Kuehnle,

concerns only the second element of this test, *i.e*, the scienter requirement.[12]

In *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), this Court left open the question whether recklessness could satisfy the scienter requirement for primary liability under Section 10(b) and Rule 10b-5. 425 U.S. at 194 n.12. All of the courts of appeals that have considered the question in light of *Hochfelder* have held that recklessness is sufficient to establish primary liability,[13] and that recklessness can satisfy the scienter requirement

---

Secondary Liability Under the Federal Securities Laws—Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and The Statutory Scheme, 14 J. Corp. L. 313, 320 (1988).

[12] Petitioner apparently did not argue below that the evidence was insufficient to permit a jury to find a primary violation of the securities laws. Petitioner did contend that it did not provide substantial assistance to the fraudulent scheme, and thus that respondents had not satisfied the third element of the test for aiding-and-abetting liability. The court of appeals found (Pet. App. A28), however, that there was a genuine issue of material fact as to that element, and petitioner does not contest that fact-bound ruling in its petition.

[13] See, *e.g.*, *Rolf* v. *Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 46-47 (2d Cir.), cert. denied, 439 U.S. 1039 (1978); *McLean* v. *Alexander*, 599 F.2d 1190, 1197 (3d Cir. 1979); *Broad* v. *Rockwell Int'l Corp.*, 642 F.2d 929, 961-962 (5th Cir.) (en banc), cert. denied, 454 U.S. 965 (1981); *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1024 (6th Cir. 1979); *Sundstrand Corp.* v. *Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir.), cert. denied, 434 U.S. 875 (1977); *Van Dyke* v. *Coburn Enterprises, Inc.*, 873 F.2d 1094, 1100 (8th Cir. 1989); *Nelson* v. *Serwold*, 576 F.2d 1332, 1337 (9th Cir.), cert. denied, 439 U.S. 970 (1978); *Hackbart* v. *Holmes*, 675 F.2d 1114, 1117 (10th Cir. 1982); *SEC* v. *Carriba Air, Inc.*, 681 F.2d 1318, 1324 (11th Cir. 1982).

Most courts of appeals, including the Tenth Circuit, follow the Seventh Circuit's *Sundstrand* standard, or some variant thereof, in defining recklessness. See *Hollinger* v. *Titan Capital Corp.*, 914 F.2d 1564, 1569 & n.8 (9th Cir. 1990) (en banc) (citing cases),

for aiding-and-abetting liability in at least some circumstances.[14]

In our view, recklessness should generally satisfy the scienter standard in aiding-and-abetting cases.[15] Where

---

cert. denied, 111 S. Ct. 1621 (1991). In *Sundstrand*, the court defined a reckless omission as

> a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

553 F.2d at 1047.

[14] See, *e.g.*, *Cleary* v. *Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *Ross* v. *Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *Akin* v. *Q-L Investments, Inc.*, 959 F.2d 521, 526-527 (5th Cir. 1992); *Herm* v. *Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *Robin* v. *Arthur Young & Co.*, 915 F.2d 1120, 1126 (7th Cir. 1990), cert. denied, 111 S. Ct. 1317 (1991); *Camp* v. *Dema*, 948 F.2d 455, 459-460 (8th Cir. 1991); *Levine* v. *Diamanthuset, Inc.*, 950 F.2d 1478, 1484-1485 & nn.4-5 (9th Cir. 1991); *Woods* v. *Barnett Bank*, 765 F.2d 1004, 1010 (11th Cir. 1985); see also *Dirks* v. *SEC*, 681 F.2d 824, 844-845 & n.27 (D.C. Cir. 1982) (opinion of Wright, J.) rev'd on other grounds, 463 U.S. 646 (1983).

[15] One possible exception to the general rule that recklessness should suffice to establish scienter in aiding-and-abetting cases involves cases in which the defendant's substantial assistance consists of pure inaction or silence and the defendant has no independent duty to disclose or act. A number of courts have indicated that evidence of conscious intent to aid the fraudulent scheme is or may be required before aiding-and-abetting liability may be imposed in such cases. See, *e.g.*, Pet. App. A17-A18; *Schneberger* v. *Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988), cert. denied, 490 U.S. 1091 (1989); *Moore* v. *Fenex, Inc.*, 809 F.2d 297, 303-304 (6th Cir.), cert. denied, 483 U.S. 1006 (1987); *Metge* v. *Baehler*, 762 F.2d 621, 625 & n.1 (8th Cir. 1985), cert. denied, 474 U.S. 1057 and 474 U.S. 1072 (1986); *Monsen* v. *Consolidated Dressed Beef Co.*, 579 F.2d at 800; *Woodward* v. *Metro Bank*, 522 F.2d 84, 97 (5th Cir. 1975). Other courts have suggested that there can be no aiding-and-abetting liability at all in such cases, regardless of the defendant's state of mind. See, *e.g.*, *Schatz* v. *Rosenberg*, 943 F.2d at 496-497;

primary violations are involved, recklessness has long been recognized as a form of scienter, both in securities fraud cases (see note 13, *supra*) and in common-law fraud cases (see *Restatement (Second) of Torts* § 526(b) comment e (1977); *Prosser and Keeton on the Law of Torts* § 107, at 741-742 (W. Keeton 5th ed. 1984)).[16] Recklessness is properly viewed as a form of knowing or intentional conduct,[17] because one who acts with reckless

---

Barker v. *Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495-496 (7th Cir. 1986); *Wessel* v. *Buhler*, 437 F.2d 279, 283 (9th Cir. 1971); cf. *IIT, An International Investment Trust* v. *Cornfeld*, 619 F.2d at 925-927. In this case, the court of appeals concluded that the evidence would support a finding that petitioner actively assisted the fraudulent scheme. Pet. App. A23. It is unclear whether petitioner seeks to challenge that determination in this Court (see Pet. Reply Br. 4), but in any event that fact-bound ruling does not warrant review. Thus, the question of the standards of liability applicable in "pure inaction" cases is not presented here. For that reason, petitioner's reliance (Pet. 14) on *Chiarella* v. *United States*, 445 U.S. 222 (1980), is misplaced, because this case involves affirmative action, not mere inaction and silence.

[16] Several courts of appeals expressly relied on the common law in concluding that recklessness could constitute scienter under Section 10(b). See *Mansbach*, 598 F.2d at 1024; *Sundstrand*, 553 F.2d at 1044; *Hackbart*, 675 F.2d at 1118.

[17] In *Hochfelder*, the Court recognized that "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act." 425 U.S. at 194 n.12. In addition, the Court described scienter as "knowing or intentional misconduct," *id.* at 197, indicating that something less than conscious intent can suffice to establish scienter. As one court has observed, " '[k]nowing' is a word laden with common law connotations: at common law, reckless conduct is viewed as a form of knowing conduct." *Rolf* v. *Blyth, Eastman Dillon & Co.*, 570 F.2d at 45. Thus, *Hochfelder* supports the conclusion that recklessness satisfies the scienter requirement under Section 10(b) and Rule 10b-5: "Since there is no hint in *Hochfelder* that the Court intended a radical departure from accepted Rule 10b-5 principles, it would be highly inappropriate to construe the Rule 10b-5 remedy to be more restrictive in substantive scope than its common law analogs." *Sundstrand Corp.* v. *Sun Chem. Corp.*, 553 F.2d at 1044 (footnote omitted).

disregard of the potentially harmful consequences of his actions is just as culpable as one who acts with actual knowledge of the potential consequences.[18] That rationale is fully applicable to aiding-and-abetting cases.

Moreover, practical necessities require general application of a recklessness standard to aiding-and-abetting cases. Proving a defendant's actual knowledge of fraud can be a daunting task, particularly when (as is frequently the case) the evidence is entirely circumstantial. The Securities and Exchange Commission (SEC) and private parties routinely rely on recklessness in order to avoid this difficulty of proof. To insist on actual knowledge as the sole means of establishing scienter would permit much deliberately wrongful conduct to escape liability under the securities laws. See, *e.g.*, *Rolf*, 570 F.2d at 47 ("To require in all types of 10b-5 cases that a factfinder must find a specific intent to deceive or defraud would for all intents and purposes disembowel the private cause of action under § 10(b)."); *Mansbach*, 598

[18] In the leading common-law case, *Derry* v. *Peek*, 14 App. Cas. 337 (H.L. 1889), the House of Lords stated that

> fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. * * * [I]f I thought that a person making a false statement had shut his eyes to the facts, or purposely abstained from inquiring into them, I should hold that honest belief was absent, and that he was just as fraudulent as if he had knowingly stated that which was false.

See also *Lehigh Zinc & Iron Co.* v. *Bamford*, 150 U.S. 665, 673 (1893) ("a person who makes representations of material facts, assuming or intending to convey the impression that he has actual knowledge of the existence of such facts, when he is conscious that he has no such knowledge, is as much responsible for the injurious consequences of such representations, to one who believes and acts upon them, as if he had actual knowledge of their falsity").

F.2d at 1025 ("Requiring a plaintiff to show that the defendant acted with actual subjective intent to defraud could impose a great burden upon recovery, greatly limiting the § 10(b)/Rule 10b-5 claim."). A recklessness standard is thus necessary to maintain the effectiveness of both the SEC's enforcement program and private actions. In view of the well-established principle that the securities laws should be construed liberally to effectuate their remedial purposes (see, *e.g.*, *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972); see also *Reves* v. *Ernst & Young*, 494 U.S. 56, 60-61 (1990)), recklessness should generally satisfy the scienter requirement.

b. The question whether recklessness suffices to establish scienter for aiding-and-abetting liability warrants review by this Court. Although the decision of the court of appeals on this issue is correct, and is consistent with a recent decision of the Ninth Circuit, *see Levine* v. *Diamanthuset, Inc.*, 950 F.2d at 1484-1485 & nn. 4-5,[19] the court's decision conflicts with the decisions of other courts of appeals that have adopted different approaches in this area. In particular, some courts have held that, in the absence of a duty to disclose, a defendant cannot be held liable for aiding and abetting a violation of Section 10(b) without a showing of conscious intent to defraud. See *Ross* v. *Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *Schatz* v. *Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991); cf. *Camp* v. *Dema*, 948 F.2d 455, 462

[19] The result reached by the court of appeals in this case is also consistent with the decisions of those courts that have suggested that recklessness would satisfy the scienter requirement in *all* Section 10(b) aiding-and-abetting cases. See *Herm* v. *Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *DCD Programs, Ltd.* v. *Leighton*, 833 F.2d 183, 188-189 (9th Cir. 1987); cf. *Robin* v. *Arthur Young & Co.*, 915 F.2d 1120, 1123, 1126 (7th Cir. 1990), cert. denied, 111 S. Ct. 1317 (1991) (indicating that recklessness standard applies to all aiding-and-abetting claims under Seventh Circuit's test for aiding-and-abetting liability).

(8th Cir. 1991) ("Because [defendant] did not owe [plaintiff] a duty to disclose, the knowledge requirement may not be satisfied by recklessness."); *id.* at 463.[20] Under the test for aiding-and-abetting liability announced by those courts, recklessness would not suffice to impose liability on petitioner as an aider and abettor.[21]

In addition, several circuits have applied what is known as the "sliding scale" approach, under which the degree of scienter required for aiding-and-abetting liability varies depending on the nature of the defendant's conduct and the presence or absence of a duty to disclose.[22] Under that approach, a defendant who acts affirmatively to assist a fraudulent scheme but who has no duty to disclose is liable for aiding and abetting only if the plaintiff can prove "conscious intent[,] unless the character and degree of the [defendant's] assistance is unusual, * * * in which case recklessness will suffice." *Akin* v. *Q-L Investments, Inc.*, 959 F.2d 521, 531 (5th Cir. 1992). Thus, unlike the rule announced by the court of appeals in this case, the "sliding scale" approach does not automatically lead to a recklessness standard where the defendant owes no duty to disclose but engages in affirmative conduct that assists the underlying fraud.[23]

[20] But see *FDIC* v. *First Interstate Bank*, 885 F.2d 423, 432-433 (8th Cir. 1989) (applying recklessness standard where defendant actively assisted the fraudulent scheme, despite apparent absence of duty to disclose to plaintiff).

[21] Unlike the court of appeals in this case (see Pet. App. A23-A25; see also *FDIC* v. *First Interstate Bank*, 885 F.2d at 433), the courts in *Schatz*, *Ross*, and *Camp* did not expressly address the question whether the level of scienter required for aiding-and-abetting liability should depend on whether a defendant assists the primary violation through affirmative action rather than through inaction and silence. In each of those cases, however, the defendant engaged in affirmative conduct that assisted the fraudulent scheme in some way, so those decisions must be viewed as rejecting the distinction relied upon by the court of appeals below. See *Schatz*, 943 F.2d at 489, 494 (defendant attorneys drafted closing documents that contained misrepresentations); *Ross*, 904 F.2d at 821-822 (defendant stock clearing agent took steps to terminate relationship with primary violator, but then rescinded decision and continued clearing trades for primary violator, including the allegedly fraudulent trade giving rise to the lawsuit); *Camp*, 948 F.2d at 457-458, 462, 464 (one defendant voted to approve allegedly fraudulent transaction and otherwise assisted scheme; other defendant's "actions were those necessary to consummate the [allegedly fraudulent] sale of stock").

[22] See, *e.g.*, *Woodward* v. *Metro Bank*, 522 F.2d 84, 95-97 (5th Cir. 1975); *Metge* v. *Baehler*, 762 F.2d 621, 624-625 (8th Cir. 1985), cert. denied, 474 U.S. 1057 and 474 U.S. 1072 (1986); *Schneberger* v. *Wheeler*, 859 F.2d 1477, 1480-1481 (11th Cir. 1988), cert. denied, 490 U.S. 1091 (1989).

Accordingly, review is warranted to reconcile these conflicting decisions and to make clear that recklessness is the appropriate standard of scienter in all aiding-and-abetting cases in which the defendant has affirmatively acted to assist the primary violation in some way. We recognize that the interlocutory nature of the decision below militates against immediate review by this Court. See, *e.g.*, *Brotherhood of Locomotive Firemen* v. *Bangor & A. R.R.*, 389 U.S. 327, 328 (1967) (per curiam); *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916); *American Construction Co.* v. *Jacksonville, T. & K.W. Ry.*, 148 U.S. 372, 384 (1893).

[23] In this case, the court of appeals found that petitioner's conduct in agreeing to delay the independent review of the 1988 appraisal was unprecedented, and that the underlying transaction was not merely "the daily grist of the mill." Pet. App. A26, quoting *Woodward*, 522 F.2d at 97. Given these findings, it seems likely that the "sliding scale" approach would call for a recklessness standard on these facts as well, and thus the holding below is not directly inconsistent with the decisions adopting the "sliding scale" approach. Nonetheless, the rule adopted by the court of appeals below could lead to inconsistent results in other cases in which the defendant provided ordinary yet affirmative assistance to a fraudulent scheme. See, *e.g.*, *Schneberger* v. *Wheeler*, 859 F.2d at 1480-1481 (under "sliding scale" approach, court refused to impose aiding-and-abetting liability on defendant who did not have "knowledge of fraud," even though defendant had affirmatively assisted the fraud to a "slight" degree).

Nonetheless, it is well-established that "where * * * there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for certiorari, the case may be reviewed despite its interlocutory status." R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 225 (6th ed. 1986) (citing cases). The issue of law presented in this case is not likely to be sharpened by factual elaboration at trial, and the question is clearly one that would otherwise qualify as a basis for certiorari.

* * * * *

In the almost two decades since this Court's decision in *Ernst & Ernst* v. *Hochfelder, supra,* numerous courts of appeals have addressed the question at issue in this case, and they have adopted at least three partially inconsistent approaches to its resolution. There is no indication that the conflict is lessening with time, or that further consideration by the lower courts will shed additional light on the issue. The question of the standards applicable to claims of aiding-and-abetting liability under Section 10(b) and Rule 10b-5 is one that arises frequently, and it is of great importance to the enforcement of the federal securities laws and the proper functioning of the Nation's financial markets. Accordingly, the petition for a writ of certiorari should be granted with respect to that issue.

CONCLUSION

The petition for a writ of certiorari should be granted with respect to the second question presented, and denied in all other respects.

Respectfully submitted.

WILLIAM C. BRYSON
Acting Solicitor General

MAUREEN E. MAHONEY
Deputy Solicitor General

THOMAS G. HUNGAR
Assistant to the Solicitor General

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

BRIAN D. BELLARDO
Assistant General Counsel

MICHAEL G. LENETT
Special Counsel

SUSAN B. MANN
Senior Counsel
Securities and Exchange Commission

MAY 1993

☆ U. S. GOVERNMENT PRINTING OFFICE: 1993 342479 60275